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Four Questions for 2019

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Disclaimer

The views I will express today are my own and do not necessarily reflect the positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

The Big Picture

- Conflicting data and the delayed release of several key economic reports have been a challenge for forecasters.
- Lower oil prices have helped throttle back inflation pressures; the risk of higher inflation is
- Last year's GDP growth was the strongest since 2005 and inflation remained below 2%.
- The Fed is in a wait-and-see mode.

Motivation

- The first of the year is often a time to reflect on last year and to look forward to the year to come.
- Similarly, forecasters and policymakers begin to reflect on the economic possibilities for 2019.
- Several questions come to mind. Let’s narrow the list to four.

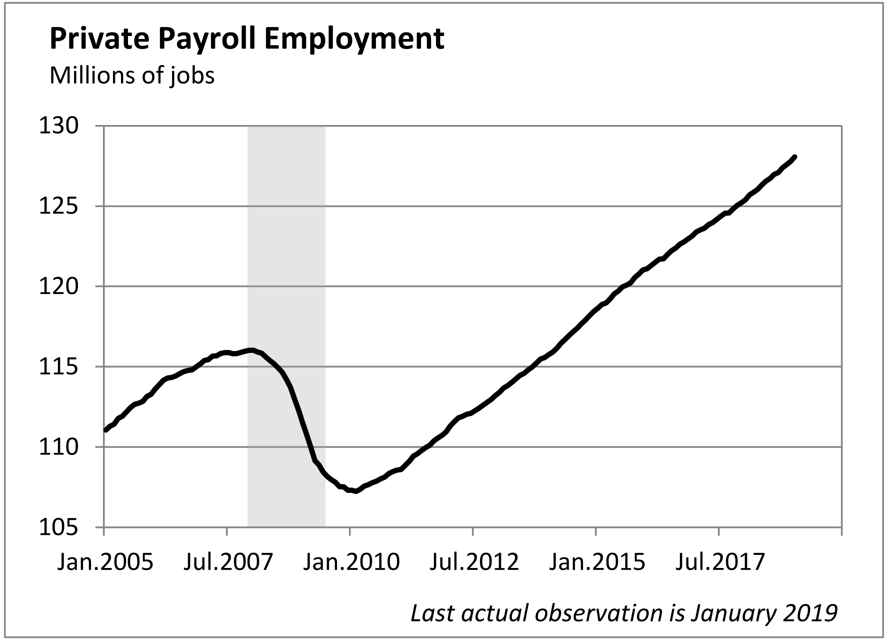
Four Questions for 2019

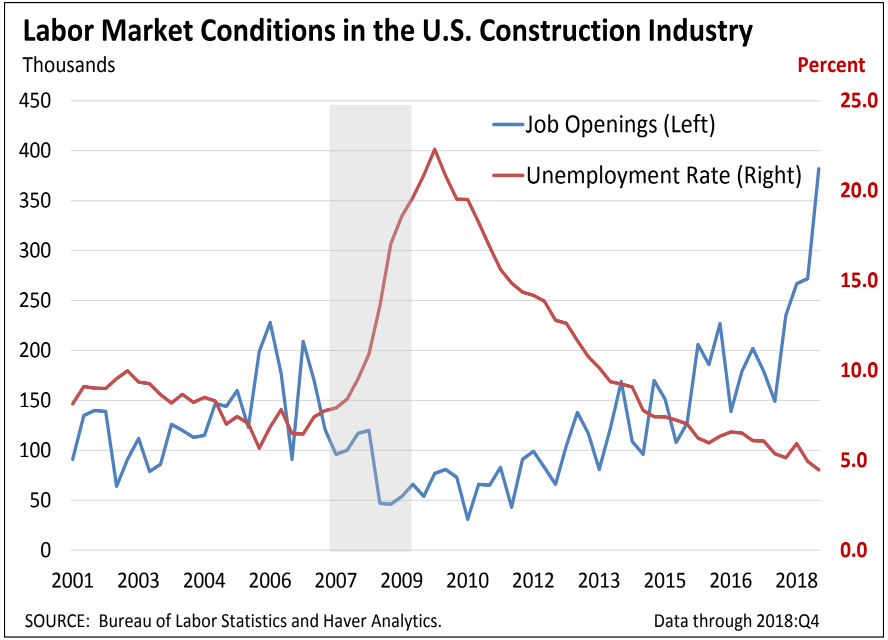
- Will job growth remain strong?
- Is inflation headed higher?
- Will the FOMC raise rates again in 2019?
- Will there be a recession in 2019?

#1: Will Job Growth Remain Strong?

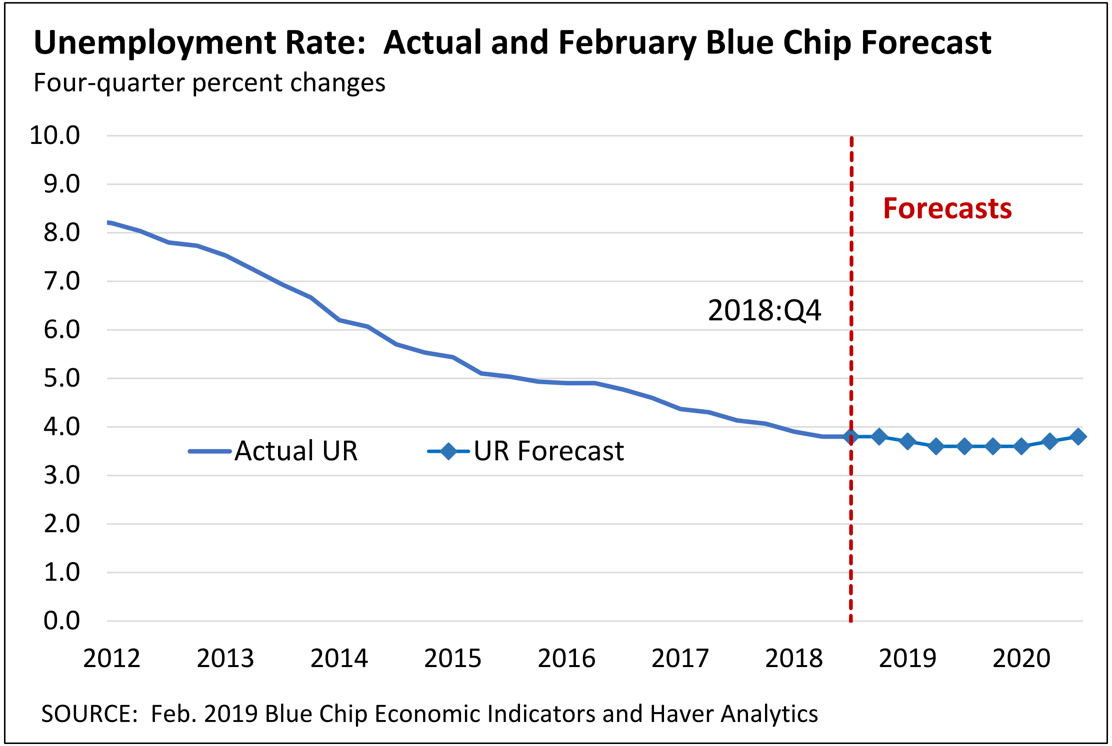
- 2.7 million jobs added in 2018. A gangbuster jobs report for January 2019.
- The U.S. unemployment rate is near a 50-year low.
- Many firms—especially in construction—continue to report labor shortages.
- Forecasts suggests solid job growth this year, further stretching tight labor markets.

Employment ↑, Job Openings ↑





Forecasters Expect the Unemployment Rate to Fall Further



A Wage Puzzle?

- Average hourly earnings rose 3.2% in 2018, the largest increase since 2008.
- But firms, and workers, should focus on total compensation (wages and salaries plus benefits).
- Rising costs of benefits can slow growth of wages.
- Solid economic growth and strong labor demand should continue to put upward pressure on labor compensation.

The Importance of Productivity

- But faster growth of labor compensation will depend importantly on productivity growth—the growth of output per hour.
- Productivity depends on many things, including investment, worker skills, and new technologies and innovations.
- Productivity growth has been picking up, albeit modestly.

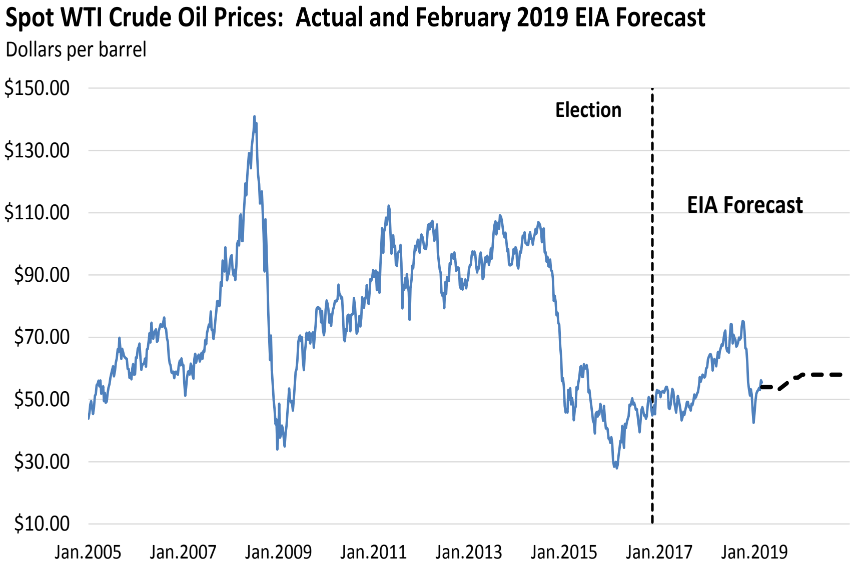
#2: Will Inflation Accelerate in 2019?

- Inflation in 2018 likely remained below 2% for the seventh straight year. Inflation expectations are tame.

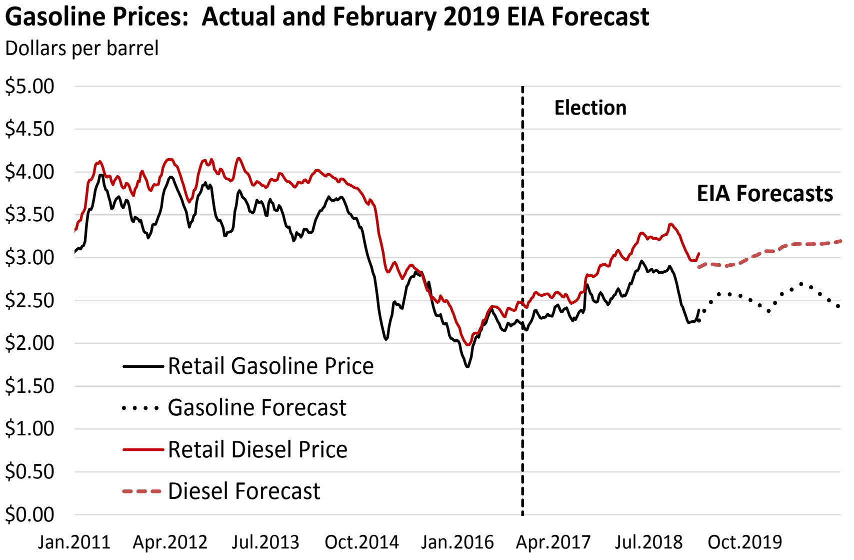
- But many see increased risk of higher inflation because the unemployment rate is near a 50-year low. I don’t.

- Others see trade-related developments (i.e., tariffs) raising inflation. But a stronger dollar and low oil prices help to offset some of these risks.

Energy Prices Projected to Firm

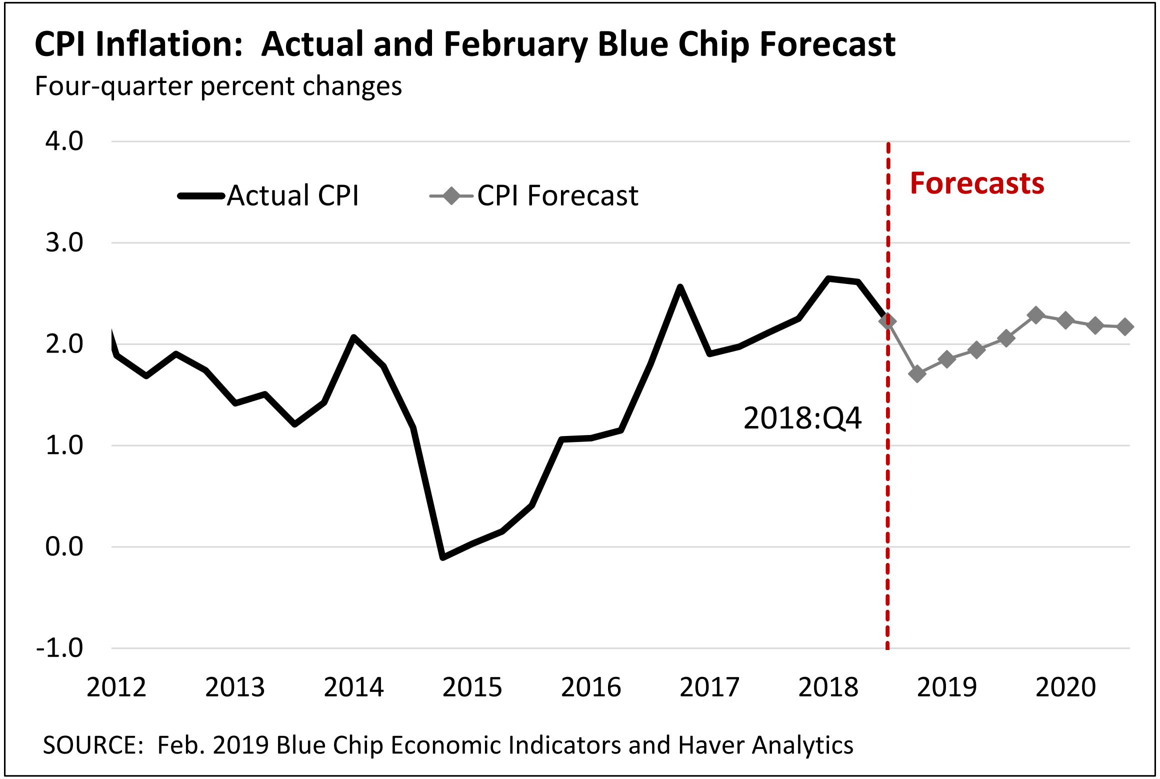


SOURCE: U.S. Energy Information Administration. **NOTE:** Last actual observation is Feb. 26, 2019



SOURCE: U.S. Energy Information Administration. **NOTE:** Last actual observation is Feb. 25, 2019

The 2% Inflation Forecast for 2019



#3: Is the Fed Done Tightening?

- At its December meeting, Fed policymakers raised rates for the fourth time in 2018.
- They signaled that more rate increases were likely in 2019 and in 2020.
- Financial markets did not react well; stocks sold off, and some forecasters raised the specter of a recession this year or next.

Patience, Grasshopper

- In the face of rising financial market turmoil, signs of weaker growth in Europe and China, and slowing inflation, Fed policymakers called an audible.

- In early January, Chairman Powell and other Fed policymakers said that they will be patient in assessing how the economy responds to rate increases.

- This is data-dependent policy in action.

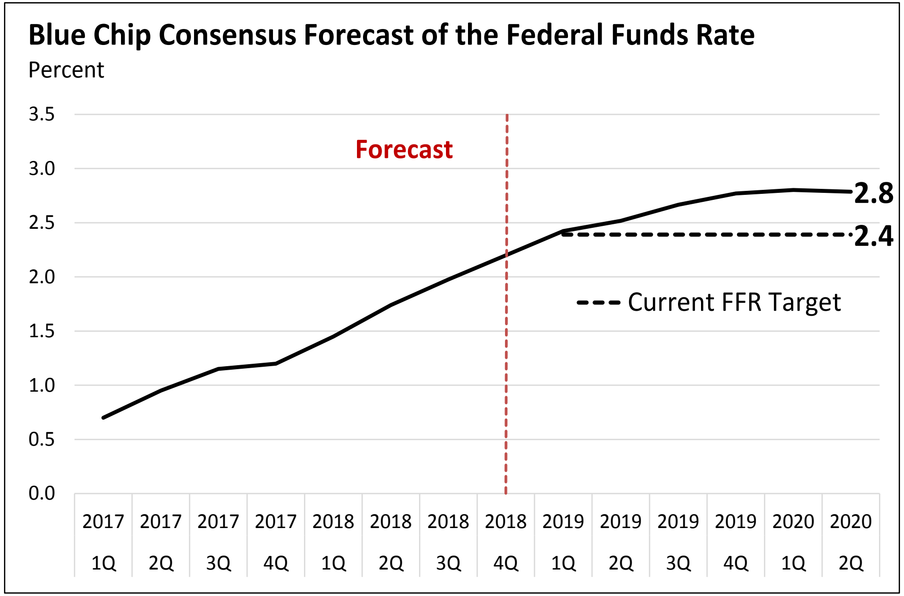
So, More Rate Hikes in 2019?

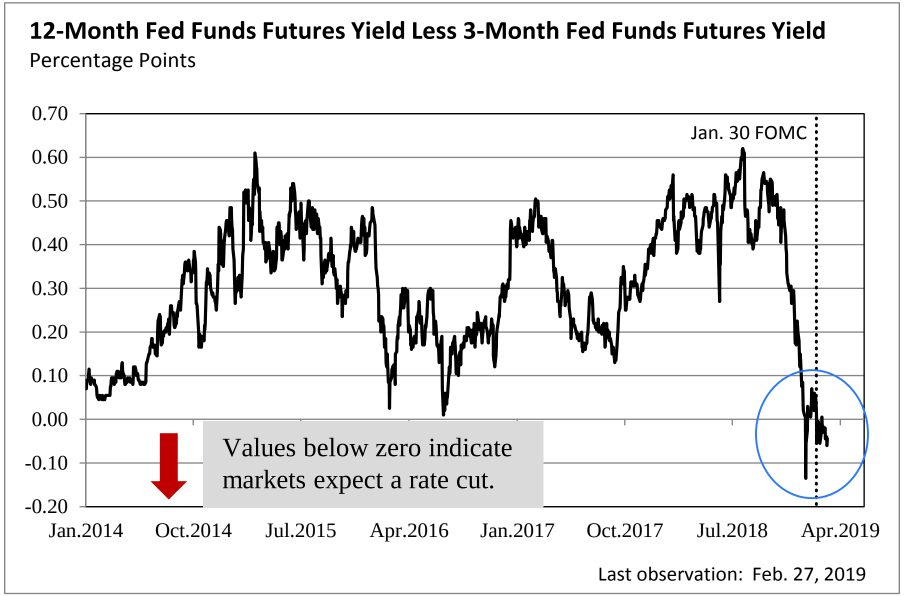
- We’re against them—and others are have come around to our view.

- What’s the case for more hikes? It mostly boils down to strong labor markets (Phillips curve). Others want policy “space”—raise more to cut more. That’s crazy!

- What’s the case for staying put? Inflation and inflation expectations have softened. There are some downside risks to the real economy.

Forecasters vs. Financial Markets on the Direction of Fed Policy





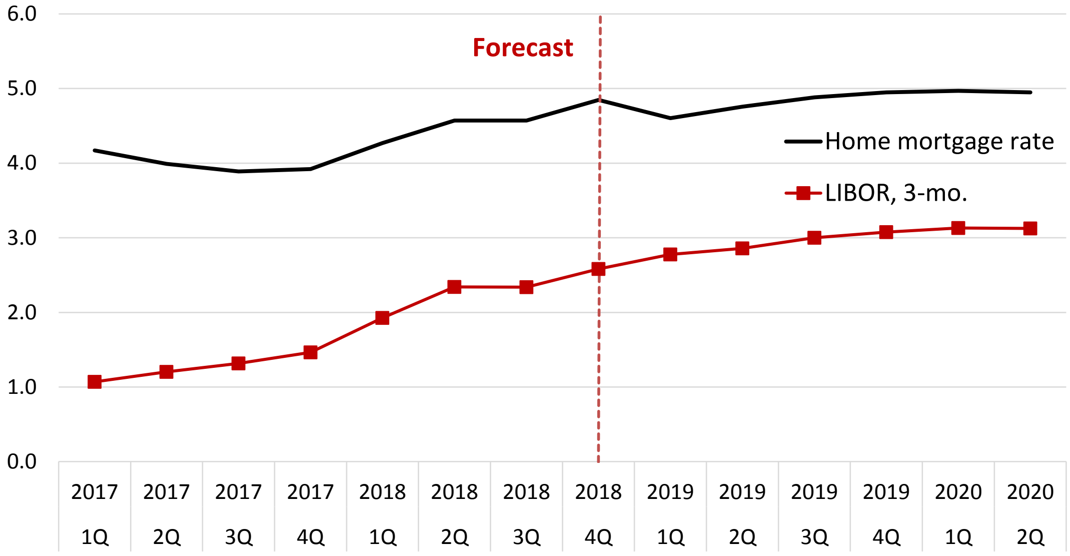
Forecasters

Financial Markets

Forecasters: A Modest Upswing in Borrowing Rates

Blue Chip Consensus Forecasts: 30-Year Mortgages and LIBOR

Percent

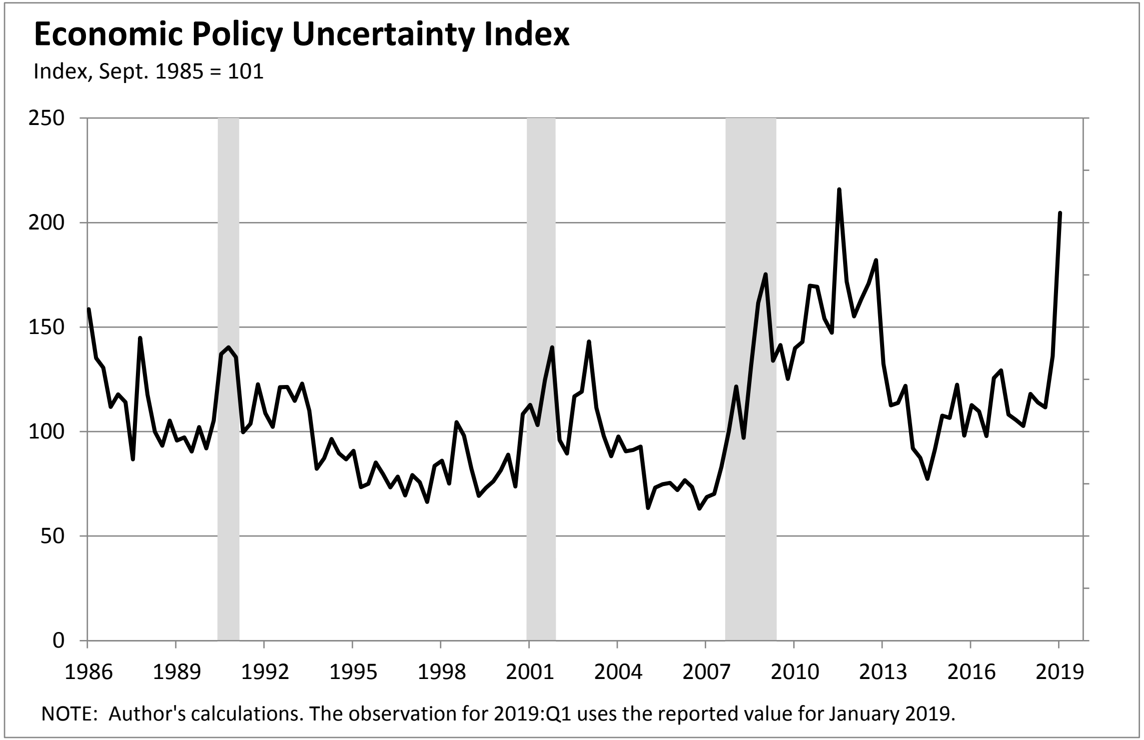


SOURCE: Haver Analytics and Blue Chip Financial Forecasts (Feb. 2019)

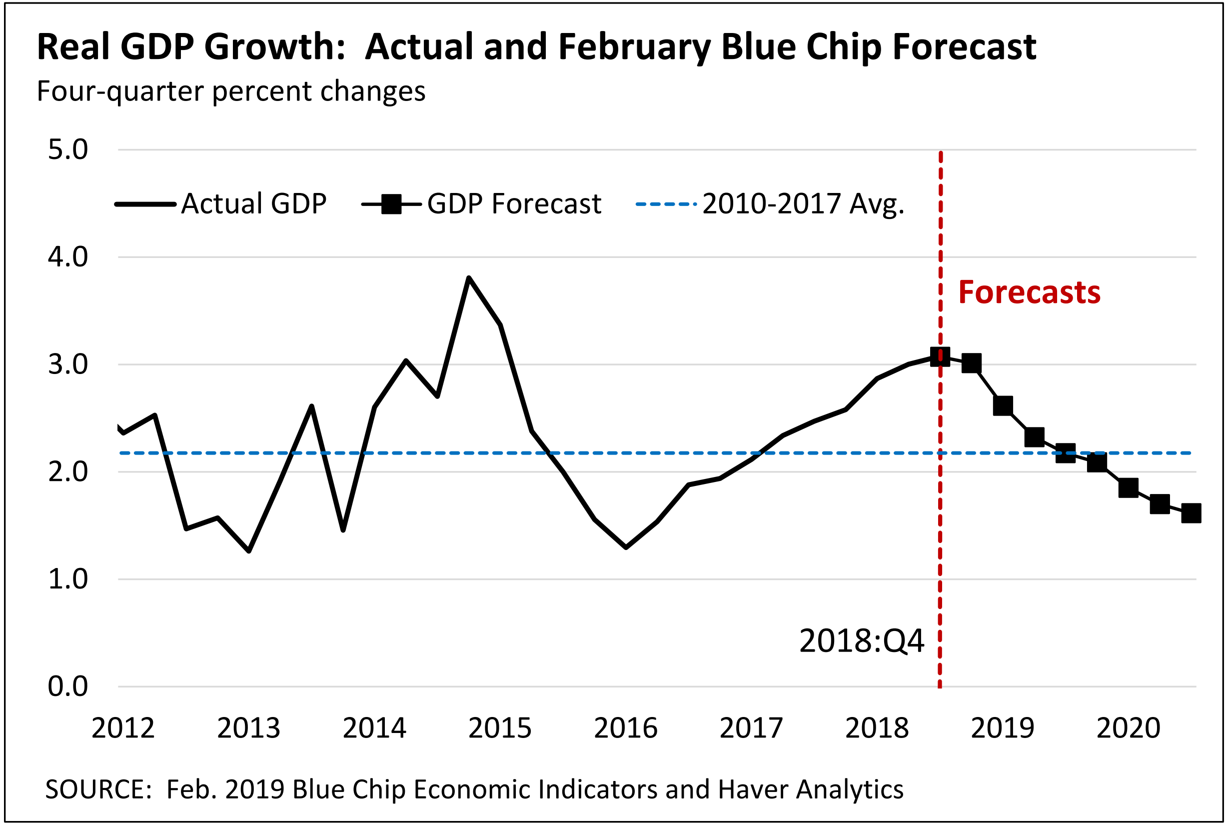
#4: A Recession in 2019?

- That’s not our forecast, but the probability isn’t zero.
- Recession signals are mixed: The yield curve is flat and housing has weakened, but labor markets and consumer spending suggest continued solid growth.
- Headwinds, tailwinds, and whirlwinds: Trade policy; fiscal stimulus; and financial market volatility.
- Headwinds + whirlwinds = rising uncertainty.

Riders on the Storm: Rising Uncertainty



The No-Recession Forecast



Recession Probabilities

2019: 26%

2020: 39%

Main Takeaways.

- Although recession risks are modestly elevated, most forecasters expect weaker, though still solid, growth in 2019.
- Inflation has slowed, helped by the plunge in crude oil prices. We see some risk of even lower inflation in 2019.
- Financial markets expect the FOMC keep its powder dry in 2019. By some measures the Fed is too tight now.

QUESTIONS?

St. Louis Fed Resources

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News and views about the economy and the Fed

Economic Education Resources
For every stage of life

Community Development
Promoting financial stability of families, neighborhoods

SOCIAL MEDIA

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ECONOMY MUSEUM AT THE ST. LOUIS FED